

## Cash flow statements (Lecture A883 – 5.25 minutes)

FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* deals with the cash flow statement (or 'statement of cash flows' as it is referred to in FRS 102) in Section 7 *Statement of Cash Flows*.

The cash flow statement is one of the primary financial statements and hence is given equal prominence to that of the profit and loss account, balance sheet and statement of changes in equity.

In recent years, the cash flow statement has been the subject of criticism from professional bodies and regulators due to some common errors that can result in the statement becoming misleading.

This article examines the accounting concepts in FRS 102, Section 7. The auditing aspects will be considered later.

### Cash flow classifications

The cash flow statement provides the user with information about how the reporting entity has generated cash and what it has spent that cash on. The statement itself is prepared on a cash basis and forms a link between the profit and loss account and the balance sheet. This link allows the user to assess various factors which could affect the entity's liquidity, financial flexibility, profitability and overall risk.

### Operating activities

Operating activities are the day-to-day revenue-producing activities of the business. FRS 102, para 7.4 contains the following examples of operating cash flows:

- (a) *cash receipts from the sale of goods and the rendering of services;*
- (b) *cash receipts from royalties, fees, commissions and other **revenue**;*
- (c) *cash payments to suppliers for goods and services;*
- (d) *cash payments to and on behalf of employees;*
- (e) *cash payments or refunds of **income tax**, unless they can be specifically identified with financing and investing activities;*
- (f) *cash receipts and payments from investments, loans and other contracts held for dealing or trading purposes, which are similar to **inventory** acquired specifically for resale; and*
- (g) *cash advances and loans made to other parties by **financial institutions**.*

Please note, FRS 102 (September 2024) contains an additional operating cash flow in respect of payments for short-term leases, payments for leases of low-value asset and variable lease payments not included in the measurement of the lease liability as required by FRS 102, Section 20 *Leases*. FRS 102, para 7.4(h) is effective for accounting periods commencing on or after 1 January 2026 with early adoption permissible provided all the periodic review amendments are applied at the same time.

A further small amendment in FRS 102 (September 2024) relates to paragraph 7.4(f) where the term 'contracts' is set in **bold** type to confirm that this is a defined term in the Glossary.

### Example – Operating activities

During the year, Greaves Industries Ltd paid corporation tax of £22,000 to HM Revenue and Customs. The company prepares its financial statements under FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* and is not a qualifying entity.

The corporation tax payment would be shown separately and classified as an operating cash flow unless the tax can be specifically identified with financing and investing activities

### Investing activities

Cash flows from investing activities arise from the acquisition and disposal of an entity's long-term assets and other investments which are not included in cash equivalents. FRS 102, para 7.5 provides the following examples of investing activities:

- (a) *cash payments to acquire **property, plant and equipment** (including self-constructed property, plant and equipment), **intangible assets** and other long-term assets. These payments include those relating to capitalised **development** costs and self-constructed property, plant and equipment;*
- (b) *cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;*
- (c) *cash payments to acquire equity or debt instruments of other entities and interests in **joint ventures**, including the net cash flows arising from obtaining **control** of **subsidiaries** or other businesses (other than payments for those instruments classified as cash equivalents or held for dealing or trading);*
- (d) *cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures, including the net cash flows arising from losing control of subsidiaries or*

*other businesses (other than receipts for those instruments classified as cash equivalents or held for dealing or trading);*

- (e) cash advances and loans made to other parties (except those made by financial institutions – see paragraph 7.4(g));*
- (f) cash receipts from the repayment of advances and loans made to other parties;*
- (g) cash payments for futures contracts, forward contracts, (a) (option contracts and swap contracts, except when the contracts are held for dealing or trading, or the payments are classified as financing activities; and*
- (h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts, except when the contracts are held for dealing or trading, or the receipts are classified as financing activities.*

*When a contract is accounted for as a hedge (see Section 12 Other Financial Instruments Issues), an entity shall classify the cash flows of the contract in the same manner as the cash flows of the item being hedged.*

#### **Example – Investing activities**

Ratchford Enterprises Ltd manufactures chemicals for use in domestic detergent products. It has four branches throughout the UK and has a year end of 30 September 2024. Demand for the company's products has seen a sharp rise in the last two years and on 1 January 2024, the company opened another branch in the south of the UK and purchased a building outright to house their operations which resulted in a cash outflow of £100,000.

Only expenditure which results in a recognised asset on the balance sheet is eligible to be classified as an investing activity and in this instance the cash payment of £100,000 will be treated as a cash flow from investing activities.

#### **Financing activities**

Financing activities are those activities which result in a change in the size and composition of the contributed borrowings and equity structure of the business. FRS 102, para 7.6 provides the following examples of financing cash flows:

- (a) cash proceeds from issuing shares or other equity instruments;*
- (b) cash payments to **owners** to acquire or redeem the entity's shares;*
- (c) cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings;*
- (d) cash repayments of amounts borrowed; and*

- (e) *cash payments by a lessee for the reduction of the outstanding **liability** relating to a **finance lease**.*

FRS 102 (September 2024) reflects some small amendments to paragraph 7.6 made by the FRC in its periodic review. Paragraph 7.6(e) has been reworded to state:

*Cash payments by a lessee for the principal portion of the lease liability.*

### **Example – Financing activities**

Naylor Industries Ltd has a year end of 30 June 2024. On 20 June 2024, the company declared a dividend to its ordinary shareholders which gave rise to a cash outflow of £50,000 that took place on 23 June 2024. The entity has presented the cash outflow as a financing cash flow in the cash flow statement.

Dividends and interest payments are permitted to be treated as operating, investing or financing cash flow because they can be regarded as any of these. However, they must be treated consistently and presented separately from other cash flows. If Naylor Industries has a policy as treating dividends as a financing cash flow and follows that policy consistently, the treatment is appropriate.

It is worth noting that if the dividend was not settled prior to the year end, it would not be shown in the current year's cash flow statement

### **Methods of reporting operating cash flows**

FRS 102, Section 7 provides for two possible methods for reporting cash flows from operating activities:

- (a) the indirect method; or
- (b) the direct method.

#### **Indirect method**

Under the indirect method, the net cash flow from operating activities is arrived at by adjusting profit or loss for the effects of non-cash items reported in profit or loss and fluctuations during the accounting period in stock, debtors and creditors as well as other items for which the cash effects relate to investing or financing activities of the entity.

### Example – Indirect method

	2024 £	2023 £
Operating profit	6,261	6,063
Depreciation charges	539	475
Loss on disposal of fixed assets	-	62
Gain on disposal of fixed assets	(125)	-
Equity-settled share-based payment expense	156	208
Decrease (increase) in trade and other debtors	(140)	139
Decrease (increase) in stock	27	(14)
(Decrease) increase in trade and other creditors	222	149
<b>Cash generated from operations</b>	<b>6,940</b>	<b>7,082</b>
Interest paid	(1,650)	(1,110)
Interest received	12	14
Tax paid	(1,254)	(1,657)
<b>Cash flow from operating activities</b>	<b>4,048</b>	<b>4,329</b>

### Direct method

The direct method of preparing the cash flow statement is useful for the users because it reports the major classes of gross operating cash receipts and gross operating cash payments. However, the reality is that the indirect method is the method which is most common (and is equally acceptable).

Under the direct method, information is disclosed about the major classes of gross receipts and gross cash payments. An example is shown below:

	2024 £	2023 £
Collections from trade debtors	4,217	4,420
Payments to suppliers	(2,142)	(2,162)
Payments to employees	(657)	(569)
Payments of corporation tax	(64)	(138)
Payments relating to retirement benefits	(235)	(252)
<b>Cash flows from operating activities</b>	<b>1,119</b>	<b>1,299</b>

## Reconciliation of net debt

FRS 102, para 7.22 requires the entity to disclose an analysis of changes in net debt from the beginning of the reporting period to the end, showing changes arising from:

- (a) the cash flows of the entity;
- (b) the acquisition and disposal of subsidiaries;
- (c) new finance leases entered into;
- (d) other non-cash changes; and
- (e) the recognition of changes in market value and exchange rate movements.

FRS 102, para 7.22 states that when several balances (or parts thereof) from the balance sheet have been combined to form the components of opening and closing net debt, sufficient detail must be shown to enable the users to identify these balances. In addition, the analysis of net debt need not be presented for prior periods.

<b>Example – Reconciliation of net debt</b>			
<b>Analysis of changes in net debt</b>	<b>At 1 January 2024</b>	<b>Cash flow</b>	<b>At 31 December 2024</b>
	£	£	£
Net cash:	122,487	459,925	582,412
Cash at bank			
Bank overdrafts	<u>(4,605,484)</u>	<u>(15,249)</u>	<u>(4,620,733)</u>
	<b>(4,482,997)</b>	<b>444,676</b>	<b>4,038,321</b>
Borrowings:			
Borrowings falling due within one year	-	(46,768)	(48,768)
Borrowings falling due after more than one year	-	<u>(201,232)</u>	<u>(201,232)</u>
	-	<u>(250,000)</u>	<u>(250,000)</u>
<b>Total</b>	<b><u>(4,482,997)</u></b>	<b><u>194,676</u></b>	<b><u>(4,288,321)</u></b>

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## Supplier finance arrangements

At the same time as publishing the periodic review amendments, on 24 March 2024, the FRC finalised a further amendment to FRS 102, Section 7 to introduce disclosure requirements for supplier finance arrangements where a third-party finance provider pays an entity's supplier, and the entity repays the finance provider.

The amendments to FRS 102, Section 7 are based on the IASB®'s amendment to IAS® 7 *Statement of Cash Flows* and IFRS® 7 *Financial Instruments: Disclosures*.

Entities preparing a cash flow statement under FRS 102 (January 2022 and September 2024) will be required to disclose information, in aggregate, concerning supplier finance arrangements which will include key terms and conditions, carrying amounts of liabilities subject to the arrangements, including the effects of non-cash changes, and ranges of payment dates.

Qualifying entities (subsidiaries and intermediate parents) were previously exempt from all the requirements of FRS 102, Section 7. However, they will now only be exempt from the supplier finance disclosure requirements if equivalent disclosures are included in the consolidated financial statements.

### What would be a supplier finance arrangement?

In a nutshell, a supplier finance arrangement is where a finance provider offers to pay the supplier of goods or services of an entity, and the buyer agrees to pay the financier at the same date or at a later date.

**Keep in mind that for the transaction to be in scope of a supplier finance arrangement, the buyer must have a liability to the supplier and the finance provider must be offering to pay that supplier.**

Alternative references to 'supplier finance arrangements' include:

- Supply chain finance
- Payables finance
- Reverse factoring

### What would NOT be a supplier finance arrangement?

There are some common types of working capital arrangements which do not involve a financier paying amounts owed by an entity to its suppliers. These sorts of transactions would not be in scope of a supplier finance arrangement and hence would not be disclosable as such. Examples would include:

- Receivable financing (e.g. invoice discounting/factoring)
- Inventory financing (e.g. a revolving line of credit from a financier)

- Credit enhancements (e.g. financial guarantees or letters of credit)
- Credit card facilities or other such types of facility

### Disclosure requirements

The following disclosures are required **in aggregate** for supplier finance arrangements:

- Key terms and conditions of the arrangements. Note, where terms and conditions are dissimilar, they should be disclosed separately.
- At the end of the reporting period:
  - i. carrying amounts and associated line items presented in the balance sheet of the financial liabilities that are part of a supplier finance arrangement;
  - ii. the range of payment due dates (e.g. 30 days from invoice date) for both the financial liabilities disclosed under i above and comparable trade creditors that are not part of a supplier finance arrangement. (Comparable trade creditors are, for example, trade creditors of the entity within the same line of business or jurisdiction as the financial liabilities disclosed in i above.

If ranges of payment due dates are wide, an explanatory information disclosure about those (additional) ranges (e.g. stratified ranges) are disclosed.

#### Example – Qualitative disclosure information

The company participates in a supply chain financing arrangement. Under the terms of this arrangement, the bank agrees to pay amounts to a participating supplier in respect of invoices owed by the company and receives settlement from the company at a later date. The primary purpose of this arrangement is to facilitate efficient payment processing and to enable the willing suppliers to receive payments from the bank prior to the invoice settlement date.

#### Example – Quantitative disclosure information

	<b>31.12.2025</b>
	<b>£'000</b>
<b><i>Carrying amounts of liabilities that are part of a supplier financing arrangement:</i></b>	
Presented within trade and other creditors	X

**Range of payment due dates:**

Liabilities that are part of the arrangement	X days after invoice date
Trade creditors that are not part of the arrangement	X days after invoice date

FRS 102, para 7.20C(c) also requires the type and effect of non-cash changes in the carrying amounts of the financial liabilities relating to supplier finance arrangements at the end of the reporting period. Examples include:

- The impact of business combinations, such as when the acquiree has supplier finance arrangements.
- Exchange differences, such as when financial liabilities are subject to supplier finance arrangements denominated in a foreign currency.
- Other transactions that do not require the use of cash or cash equivalents.

**Example disclosure – Impact of non-cash changes**

There were no material business combinations or foreign exchange differences or other non-cash transfers relating to the carrying amount of liabilities subject to supplier finance arrangements.

**Effective date**

It should be noted that this amendment was **not** part of the periodic review amendments (it was subject to a separate consultation). These additional disclosure requirements are mandatory for accounting periods commencing on or after 1 January 2025. Early adoption is permitted.